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NSC PLEASE PASS TO DIRECTOR AL HUBBARD AND JOHN COBAU

E.O. 12958: N/A

TAGS: [PGOV](#) [ECON](#) [SENV](#) [BR](#)

SUBJECT: SCENESETTER FOR THE VISIT OF NEC DIRECTOR AL HUBBARD

REFTEL: A) BRASILIA 1819; B) BRASILIA 1813; C) BRASILIA 1826

¶1. (SBU) Summary: Your visit comes on the heels of an August visit to Brazil by State Under Secretary for Economic, Energy and Agricultural Affairs Reuben Jeffery III. During his visit, the Under Secretary's discussions with GOB officials included biofuels and infrastructure (REFTELS A, B,C). Also at the forefront of the Brazilians' agenda is the Doha Development Round (DDR) negotiations, which were set back in June when talks between the U.S., the EU, Brazil, and India stalled over disagreements concerning tariff cuts for goods and services and over agricultural subsidies. The Brazilians are also interested in a climate change agenda, although their vision of the approach may differ considerably from ours.

¶2. (SBU) While relations between the U.S. and Brazil are friendly, the USG often encounters major difficulties in gaining the cooperation of senior policymakers on issues of significant interest to the United States. Eager to assert its own influence, the Brazilian government shies away from cooperation with the USG - unless it can clearly be characterized as a reciprocal exchange among equals. In contrast, on issues involving matters perceived as technical in nature - law enforcement, science and biofuels - the GoB is eager to engage. End Summary.

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CEO Forum  
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¶3. (U) The launch of the upcoming CEO Forum will provide a new avenue for both the Brazilian and American private sector to examine the problems that hinder the trading relationship and competitiveness at large, and to make recommendations to both our governments for steps to improve. We expect that concerns about infrastructure, taxation, intellectual property rights and slow movement toward a conclusion of the Doha Round may surface in the meeting, and that the CEOs will present some specific recommendations in these, or other, areas. Maintaining the momentum and helping create movement based upon the recommendations will be an ongoing challenge for both sides.

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MACRO-ECONOMIC DEVELOPMENTS  
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¶4. (U) President Lula and his economic team have implemented prudent fiscal and monetary policies and pursued reform. Brazil's external accounts have improved substantially over the last three years. Nevertheless, initially reported 2006 GDP growth was only 2.9% (third worst in the hemisphere). In 2007, Brazil revised its methodology for calculating GDP and restated its 2006 GDP as 3.7%. For 2007, Brazil's Central Bank is forecasting 4.7% growth (slightly higher than most private sector forecasts). Inflation over the next

three years is forecast to be in line with the central bank's annual target (4.5%).

15. (SBU) Buoyed by exports and investment inflows, the real has remained at appreciated levels for most of the year, allowing the government and businesses to pay down external debt. Last year, the government eliminated the last of its restructured debt from Brazil's late-1980's default. Based upon the improving external debt dynamics, Fitch IBCA upgraded its credit rating on Brazil's sovereign debt in February 2006, to BB-.

16. (SBU) Key challenges remain. The public sector debt-to-GDP ratio is on a downward trend but remains high, at about 50%. Real interest rates are among the highest in the world; reducing them will require both reductions in the government's borrowing requirement and reform of the financial sector. Income and land distribution remain skewed. Investment and domestic savings are low, but growing. The informal sector constitutes over 40 percent of the economy, in part due to the tax burden (nearly 38 percent of GDP), one of the highest among large developing economies.

17. (SBU) Sustaining and expanding growth rates in the longer term depends on further structural reform efforts and concrete steps to create a more welcoming climate for investment, both domestic and foreign. A bill allowing Public-Private Partnerships, a key effort to attract private investment to infrastructure, passed in 2004, although implementation of this initiative still awaits promulgation of the necessary regulations. Labor reform, additional tax reform and autonomy for the Central Bank were on the agenda for 2005 to 2006, but appear unlikely to be addressed at in the near term. The government still needs to improve the regulatory climate for investment; to simplify torturous tax systems at the state and federal levels; and to further reform the pension system.

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Infrastructure  
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18. (SBU) Poor infrastructure issues have long been cited as part of the "Custo Brasil" or "Brazil Cost," a term used to refer to the systemic problems that hinder Brazil's competitiveness. For example, the interior of the country depends on a series of ill-maintained roads for transportation of goods to its aging ports.

Brazilian officials have signaled that the GOB is interested in working with the USG to explore ways to maximize funds, technology and managerial skills in infrastructure projects around the country, or possibly for the two countries' entities to invest in third countries. GoB officials have proposed that both governments work together on implementation as well as financing using a possible "tripod format" (a partnership between the GoB, a Brazilian company, and a US company) for infrastructure projects. (REFTELS A, B)

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DOHA AGENDA - WTO  
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19. (SBU) Brazil has used the Doha Development Agenda (DDA) negotiations as the main forum for engaging with developed country partners. Brazil leads the G-20 group of developing countries in pressing for agricultural trade desires in the DDA. Brazilian industry leaders and GoB officials have underlined that concern over the impact of Chinese imports on domestic manufacturers is one root cause behind their unwillingness to agree to the non-agricultural tariff cuts proposed by both the USG and the EU during the Doha Round. To date, Brazilian proposals do not provide real market access. China has increased in importance as an export market for Brazilian soy, iron ore, and steel, becoming Brazil's fourth largest trading partner. Impelled by a stronger real, this year China is set to become the second largest exporter to Brazil, passing Argentina and second only to the U.S. Low-priced Chinese imports, particularly in the textile, footwear, and toy sectors, are now threatening to displace domestic Brazilian production.

110. (SBU) Brazil's objections to US agricultural programs has

sparked initiation of a WTO case. In the cotton dispute, some in the Brazilian congress have introduced an IPR "cross-retaliation" bill - a proposal that has some executive branch support and is slowly winding its way through the Brazilian congress.

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TRADE POLICY AND MERCOSUL  
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¶11. (SBU) The GoB is seeking expanded trade ties with developing countries and seeks to strengthen the Mercosul customs union with Uruguay, Paraguay, and Argentina. Still, the Brazil-Argentina relationship is rife with trade disputes and Uruguay and Paraguay regularly complain that Brazil and Argentina reap a disproportionate share of benefits from the block. The bloc has moved toward an increasingly political form, it remains engaged in external trade negotiations. Mercosul has free trade agreements with Colombia, Ecuador, Venezuela, Peru, Chile and Bolivia. In addition to Cuba, the bloc has explored free trade talks with Israel, the Dominican Republic, Panama and states of the Gulf Cooperation Council. Mercosul has also tried to build on partial trade liberalization agreements concluded with India and South Africa in 2004. Brazil has not yet ratified Venezuela's full membership in Mercosul. In an August 2007 visit to Mexico, President Lula made overtures on improving the countries' bilateral trade relationship.

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BIOFUELS  
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¶12. (U) Brazil's ethanol program is a model for alternative energy. Brazil's comparative advantage is its ability to inexpensively produce ethanol from sugarcane. At the pump, ethanol receives favorable tax treatment from the Brazilian government. It is exempted from the largest federal tax on gasoline (CIDE) and is subject to lower rates on two other federal levies (PIS and COFINS). Nevertheless, ethanol prices can vary substantially from state to state. In contrast, gasoline prices vary less and are controlled by the government.

¶13. (SBU) Since the 1980s, Brazil has attempted to promote ethanol fuel exports to the United States. U.S. tariffs and charges make Brazilian imports less competitive. In addition to import tariffs of 1.9 to 2.5 percent, the U.S. imposes a 54 cents/gallon surcharge on ethanol imported for use as fuel, which has led to a strong Brazilian push to lower or eliminate it. (Comment: Brazil is able

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to sidestep in part the surcharge by exporting a large volume of ethanol to Caribbean countries, which then do some processing and ship the finished product to the United States under favorable treatment established by the Caribbean Basin Initiative. End Comment.) Given the requirements of its fast-growing domestic market, Brazil may not be able to produce enough ethanol to supply international markets. Some estimate that over the next one to two years, the maximum percentage of Brazil's cane crop that could be devoted to ethanol production is 54%. If so, this would mean that Brazilian ethanol production is already running at 95 percent of capacity; and the country's ability to expand its sugarcane acreage is limited to perhaps 20 percent over the next 3-4 years.

¶14. (SBU) In the first (August 20, 2007) meeting of the USG-GoB Biofuels Steering Committee established under the March 7 DOS/MRE MOU, officials from both countries emphasized the need to move quickly in the area of standardization to enable future collaboration and make biofuels a global commodity. Representatives also agreed on the need for private sector involvement to spur momentum and keep pace with the market in the biofuels race. Under the MOU, joint participation in third party biofuels initiatives in St. Kitts (August), El Salvador (September) and in the Dominican Republic (tentatively planned for November) has begun, NIST-led standards work is on-going, and DOE/USDA hosted a delegation of Brazilian scientists.

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AGRICULTURE  
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¶15. (U) Agriculture is a major sector of the Brazilian economy, and accounts for 13% of GDP (and 30% when including agribusiness) and 33% of Brazilian exports. Brazil is the world's largest producer of sugar cane, coffee, tropical fruits, frozen concentrated orange juice (FCOJ), and has the world's largest commercial cattle herd (50% larger than the U.S.) at 180 million head. Brazil is also an important producer of soybeans (second to the United States), corn, cotton, cocoa, tobacco, and forest products. The remainder of agricultural output is in the livestock sector, mainly the production of beef and poultry (second to the U.S.), pork, milk, and seafood.

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FOREIGN POLICY  
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¶16. (SBU) Brazil has long seen itself as the natural leader of the region and covets a permanent UN Security Council (UNSC) seat. President Lula has run an activist foreign policy with a focus on South America and the Third World, seeking to forge alliances with other mid-sized powers (South Africa, India, etc.)- the 'South-South Policy.' Lula has refused to condemn Cuba for human rights violations and, in fact, has pushed for Cuban membership in the Rio Group and a Cuba-Mercosul trade pact. The GoB has worked to increase both its economic and political ties with Venezuela. Enhanced integration of the two countries' energy sectors is high on its agenda. Lula has been especially solicitous of Chavez. In the past, Lula has praised the Venezuelan President's democratic credentials and declared that the Chavez government had been demonized by its foes. Recently, rifts have appeared over Venezuela's apparent involvement in Bolivia's decision to nationalize its oil and gas industry and Chavez's biting remarks to Brazilian Congress members who condemned the GoV's decision to close an independent television station. President Lula and President Bush have spoken favorably of trilateral assistance, though so far this has only resulted in a joint health mission to Sao Tome and Principe. Further activities may take place in other Portuguese-speaking countries (Mozambique and Angola). At the UNGA on September 25, President Lula spoke of Iran's right to enrich uranium and its peaceful nuclear program, which undercut efforts to keep the pressure on Iran to suspend enrichment.

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ENVIRONMENT AND CLIMATE CHANGE  
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¶17. (SBU) Internationally, Brazil is an energetic advocate on environmental issues and strongly supports the Kyoto Protocol. The GoB is actively involved in international climate negotiations and strongly supports the United Nations Framework on Climate Change (UNFCCC), for which Brazil has taken an active role in the discussion of reducing emissions from deforestation. Brazil has proposed a "results-oriented" fund, which is not consistent with USG policy on climate change. Thus far, Brazilian reaction to President Bush's Global Climate Change (GCC) initiative has been lukewarm - they fear it will undermine the work of the UNFCCC. GoB officials

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have said previously that the U.S., as a non-signatory to the Kyoto Protocol, places more emphasis on energy efficiency and expense than the environment (REFTEL B). After the September 27 - 28 Major Economies Meeting (MEM) on climate change, the head of the Brazilian delegation to the MEM, Ministry of Exterior Relations Under Secretary Everton Vargas told the press, "We see only a reiteration

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of what he [Bush] has said in the past. We don't want this focus on voluntary controls." . . . Bush tried to convince the participants that now he is taking seriously the problem of global warming. But in practice, he only defended his obstinate position."

¶18. (SBU) The Brazilians also hosted a ministerial meeting that took place in Rio de Janeiro, September 3-4, which addressed strengthening international governance of sustainable development,

including a discussion of the French proposal to transform the UN Environmental Program (UNEP) into a World Environment Organization akin to the WTO. The Brazilians have revised their position and now are calling for a new "umbrella" international organization, though focused not just on environment, but also on sustainable development.

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Intellectual Property Rights (IPR)  
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¶19. (u) On April 30, 2007, the Office of the U.S. Trade Representative (USTR) elevated Brazil to "Watch List" status in its Special 301 Annual Report as a result of the country's progress, particularly in copyright protection and IPR enforcement. Included in the USTR announcement was notice that Brazil will be subject to an Out-of-Cycle Review to monitor its progress on outstanding IPR concerns and to evaluate the sustainability of recent enforcement progress. On May 4, 2007, the GoB announced the issuance of a compulsory license for Merck Pharmaceutical's HIV/AIDS medicine Stocrin. GoB officials cited cost reduction for their free HIV/AIDS public health program as the motivation for this action. In contrast, some pharmaceutical industry representatives feel new Minister of Health Jose Gomes Temporao was driven more by ideology than by concern about future damage to Brazil's investment climate as a result of this action.

CHICOLA